

White Paper

IT Investment Decision Support® for Sourcing Projects

IT Investment Decision Support® stands for a proven and recognized evaluation process for the business assessment of IT projects in general and sourcing projects in particular. The persons involved are put into a position to recognize at a glance what business impact a planned sourcing project will have in a specific environment.

This paper presents the calculation mechanisms that are basically required for this purpose. An outline of what decision makers can expect from the results is also provided.



Content	
Introduction	2
Motivation	2
Calculation model	2
Claim and target group	4
Introduction to a calculation – <i>TCO4Cloud</i>	4
Results of a <i>TCO4Cloud</i> analysis	5
Reliability of the results - <i>Prediction & Controlling</i>	6
Extract from a <i>TCO4Cloud</i> result report	7

Introduction

IT Investment Decision Support® from Fujitsu stands for a proven and recognized evaluation process for the business assessment of IT projects in general and sourcing projects in particular. It helps the persons involved to recognize at a glance what business impact a planned sourcing project in a specific environment will have on the basis of currently available data. Various business indices are determined during this evaluation (KPIs – *Key Performance Indicators*) in order to support the investment decision-making process.

In order to acquire a feeling for the reliability of these KPIs this paper provides a description of the fundamental calculation mechanisms. An outline of what decision makers can expect from the results is also provided.

Motivation

Depending on the goals and the maturity of the IT project, *IT Investment Decision Support*® can be used to illuminate a sourcing project with regard to its business aspects. In this way, investment and benefits on the one hand as well as their financial consequences on the other hand are put together to form a cluster of information and are evaluated using business methods. A project-specific and reliable decision-making document is thus developed, which can be used by all the departments in the company – from the specialist department and controlling right through to executive management.

This copyrighted process, which was developed by Fujitsu, is based on a service model that correlates with the respective maturity level of the project. This ensures that qualitatively reliable results are provided in line with the progress of the project. The correspondence of the results with the maturity level is – in addition to the calculation model – the central key for the desired high level of reliability. The consequence is a business decision-making document that is always up-to-date and virtually adapts itself to the progress of the project.

Calculation model

To ensure maximum objectivity and transparency own developments have been consciously omitted here. On the contrary, all the cost drivers used should always be accepted and also publically described. Furthermore, the calculation model used should be identical in all phases of the planned IT project. Consultants and developers have always strongly believed that a reliable business forecast can be guaranteed as a result.

The calculation model used in the *IT Investment Decision Support*® is based on GARTNER's Chart of Accounts®. This is a model that is used to determine the so-called total cost of ownership (TCO), an accounting procedure that was developed on behalf of Microsoft in 1987 by Bill Kirwin, research director of the management consultancy GARTNER.

The approach was among other things used to help companies estimate the costs incurred with IT investment goods. The idea was to have an accounting system that not only included the purchasing costs of the environment, but also all aspects of subsequent use (energy costs, repair, maintenance and operation). Due to its completeness, this basically made it possible - in addition to known cost drivers - to also identify hidden costs before making any investment decision.

In our opinion, three essential aspects should be noted for the interpretation of TCO calculations:

1. Perhaps the most important aspect - especially for the reliability of the analysis - is the distinction between direct and indirect cost drivers. Only direct cost drivers are relevant for an IT budget. This must always be taken into consideration in the argumentation for new solutions with accounting managers.
2. It should be noted for each form of calculation of this kind that it is always a best-practice approach. In contrast to other procedures from the field of economic sciences there is currently no binding stipulation, standard or doctrine for TCO. This circumstance is among other things also due to the technical and organizational heterogeneity of the IT branch of industry.
3. All known IT cost models – and thus also TCO – do not provide any approaches as to how improvements in the field of indirect costs actually affect the net income of the company. Example: Assuming that the downtime of workplace computers can be reduced from an average of two hours to one hour annually. The indirect costs that were estimated for the downtime should therefore accordingly fall by half. From a business viewpoint a positive effect would then also have to result involving precisely this amount. This effect could be allocated to various cost centers or become effective in the form of revenue - but, all in all, is always allocated to the cash flow. In practice, however, this amount influences the cash flow to an even lesser extent than in the TCO calculation.

The *IT Investment Decision Support*® process takes these observations into account. In order to ensure the business relevance and acceptance of the results direct and indirect cost drivers are strictly separated. The background to this is the fact, which was already mentioned above, that only direct cost drivers are accepted by Controlling as being relevant to the IT budget. Furthermore, one-off costs (implementation, project management), any special depreciation allowances, project duration and calculatory interest rate are also integrated in the calculation and thus provide security of the cost model used. Indirect cost drivers are taken into account insofar as the effects are at least qualified - and if requested by the customer - also quantified. However, adding the financial impacts of an IT project on both direct and indirect cost drivers in order to form a single sum is not implemented under any circumstances.

The basis for each calculation is the so-called actual/target comparison. In this case, the cost situation is recorded at a specified, as a rule present, point in time (actual) and compared with a future situation (target).

The decisive factor here is that no discrete states are compared with each other. Instead, it is more about assessing and comparing on a monetary basis two continuously changing implementations over a defined period of time. This comparison is mathematically expressed in the difference between two integrals, whose area function stands for the respective IT costs for the observed period.

It is evident from this that a specific understanding of everyone involved in the project regarding the cost situation of the planned sourcing model must already be available at the beginning of the calculation, because the appropriate critical evaluation of the target situation can only be derived in this way.

Claim and target group

Each of the two service elements in the *IT Investment Decision Support*® process, as described in the diagram, claims to supply the customer's commercial team with reliable results about the specific business implications of sourcing.

The fact that risk sharing models are also planned in *IT Investment Decision Support*® is a special feature and by all means a unique selling point. The second service element in the diagram *Prediction & Controlling* stands for this in particular. In this respect, these services - in the opinion of service providers - also set themselves pleasantly apart from the usual so-called presales services of manufacturers and providers.

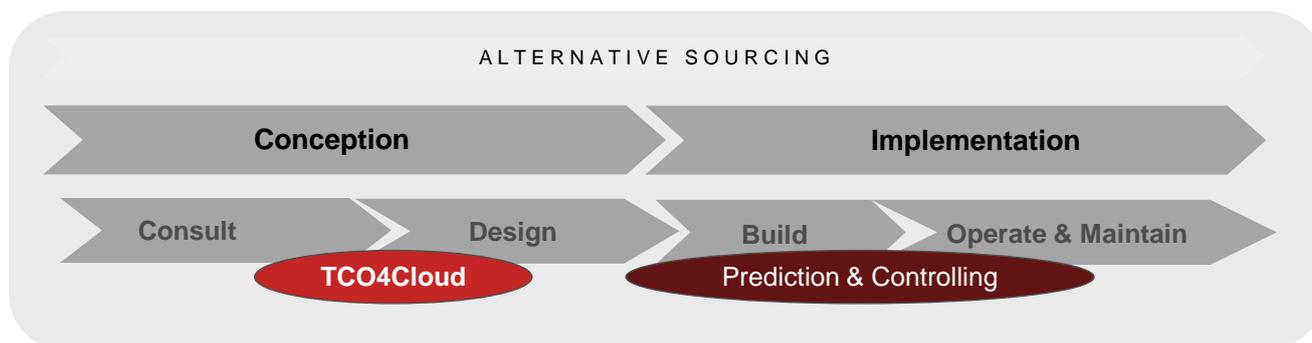


Figure 1: The two service elements in correlation to the respective maturity level of the project

Introduction to a calculation – TCO4Cloud

In the sourcing project *TCO4Cloud* stands for the typical introduction to the *IT Investment Decision Support*®. The goal with *TCO4Cloud* is to give the customer in a very early phase of the project - normally before the actual decision - a first impression of the expected business implications of the planned sourcing.

Low expenditure and speed are of great significance during this relatively early orientation and decision-making phase. Long-term and cost-intensive evaluations are critically assessed by the persons responsible no later than when it should appear that the financial expectations are not proportionate to the planned investments. On the other hand, the persons responsible definitely expect to receive meaningful and above all reliable results during the early phase.

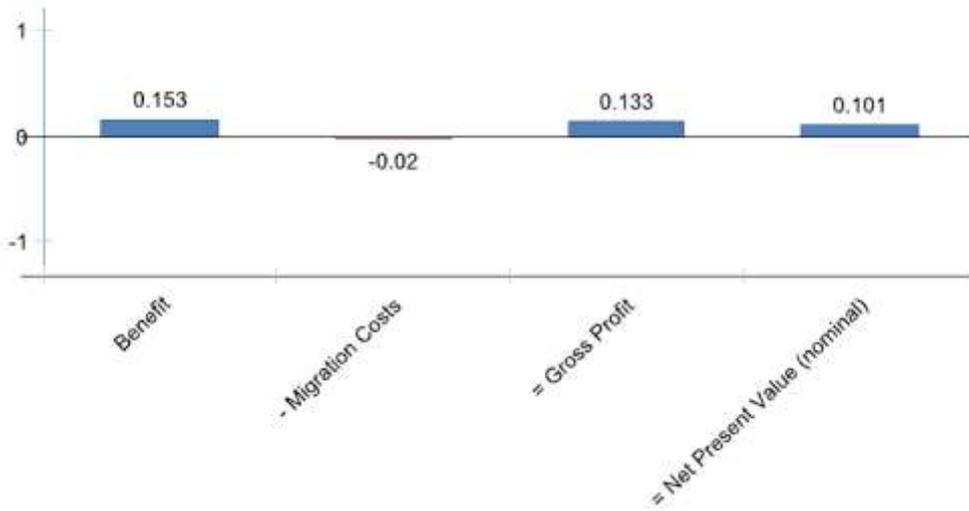
TCO4Cloud is in a position to supply reliable results in this area of conflict. Properly prepared, the consultants usually only need one day onsite, particularly for cloud projects, to discuss matters with the persons responsible within the company and generally ask for all the information they require. These discussions are accordingly prepared using checklists so that the content and scope of the questions are known to everyone taking part in the talks in advance. The result of this stage of the project is a first overview of the cost situation of the IT environment to be migrated, for which an alternative sourcing model is to be developed.

The technical target architecture does not play such a major role for the customer when sourcing in general, as it does in the infrastructure project. Requirements are formulated less on the basis of technological specification, but rather via the appropriate service level. This means for the business calculation that it will in principle suffice if the periodical investments that are required in future for the targeted sourcing model are known. As long as the price structure in the sourcing model does not change, the type and design of the underlying infrastructure does not play a role. The first results can therefore already be presented a few days after the interviews have been concluded – providing that the price structure of the future sourcing model is available.

Results of a TCO4Cloud analysis

The most important results of the TCO4Cloud analysis are supplied in the simple and precise form of a management summary. This document, which was specially conceived for CFOs and financial directors, uses KPIs to describe the monetary changes volume that has been determined and that is initiated by the sourcing project. Diagrams are also available that describe in detail which cost drivers are probably affected within the context of the planned sourcing of changes and how high the business consequences are estimated to be. The detailed process of the analysis as well as individual parameters are listed in the appropriate service description TCO4Cloud. Furthermore, anonymized sample results are available which illustrate the scope of services.

Cost/Benefit Relation



Cashflow

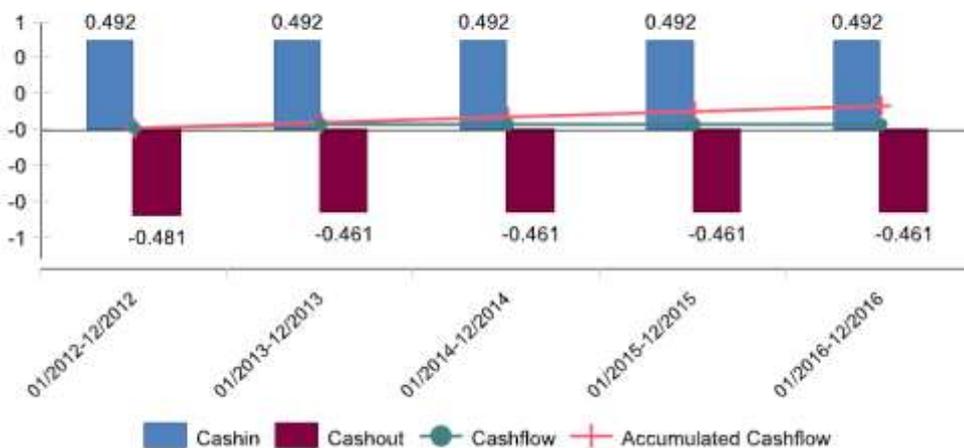


Figure 2 and 3: Costs & Revenue, as well as cash flow - classic KPIs in each business decision-making document

Reliability of the results - *Prediction & Controlling*

The reliability and precision of *TCO4Cloud* is perceived to be absolutely adequate by the overwhelming majority of project managers. In these cases the customers see no need to organize any further project-accompanying measures.

However, no statements as regards risk sharing or even "commitments" of the partners involved are associated with *TCO4Cloud*. This is also due to the requirement for speed and efficiency, which was described at the outset.

Service developers also point out that further project simulations of this kind require a substantially higher level of project maturity with a calculation basis that is characterized by very low change dynamism alone. If financial, project planning, solution, and assessment data is then available of very fine granularity and with an appropriately high degree of reliability, the time has come for the service element *Prediction & Controlling*.

This element is with regard to the fundamental procedure by all means comparable with the *TCO4Cloud* service. The difference lies in the considerably higher level of project maturity and granularity of the input to be processed and ultimately also in the extent of the documentation and quality assurance. These steps go hand in hand with a generally required refinement of the calculation model as part of the customer-specific requirements.

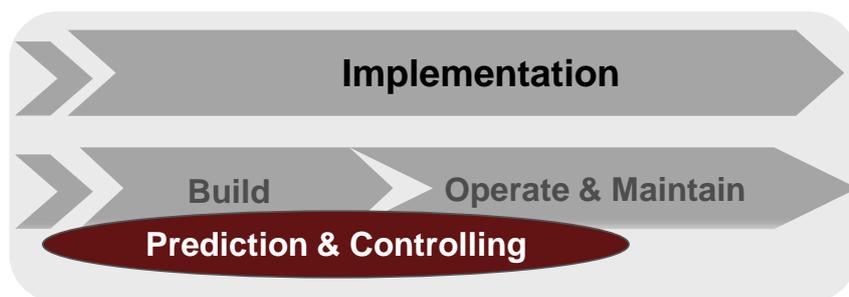


Figure 3: "Prediction & Controlling" as a service for the binding forecast of business impacts and the mapping of risk sharing models

The input for this service element is usually based on a negotiated sourcing offer as well as an agreed project plan and permits with regard to precision and the mathematical conclusions drawn on its basis hardly any degrees of freedom.

Service delivery takes place in two stages:

1. With the aid of earlier work done in this respect sourcing experts develop the customer-specific design (fine specification), which stands out for its high degree of attention to detail and precision. The migration plan is derived from this fine specification.
2. Based on this, even more accurate values (e.g. for validation during the course of the project) are determined for the already identified economic changes (optimization potential in general) and are agreed together with the persons responsible. These final values are then incorporated in an updated and refined calculation.

Check forecasts

In the *Prediction & Controlling* service element proof is now established at regular intervals as to whether planning and reality are still aligned as regards the business forecast. This is to be based on the calculation basis that was agreed when the service began.

Extract from a TCO4Cloud result report

Economical KPIs in Mio £ over a period of 60 month

Profitability Index (ROI ratio)	1 : 7.650
Benefit	0.153
- Migration Costs	0.020
= Gross Profit	0.133
Interest rate	10.000%
= Net Present Value (nominal)	0.101
Inflation rate	2.100%
= Net Present Value (real)	0.096

Cash Positive in month	8
Programme Period in weeks	9
= Extended Internal Rate of Return (XIRR)	370.662%
Return on Investment percentage	665.000%

Direct Investment	0.020
Assets	0.000
Migration service costs	0.020
Other migration cost	0.000

Description	Current TCO	New TCO	TCO reduction
Hardware	1.360	0.000	1.360
Labour	0.337	0.000	0.337
External services	0.546	2.305	-1.759
Miscellaneous OpEx	0.215	0.000	0.215
Total	2.458	2.305	0.153